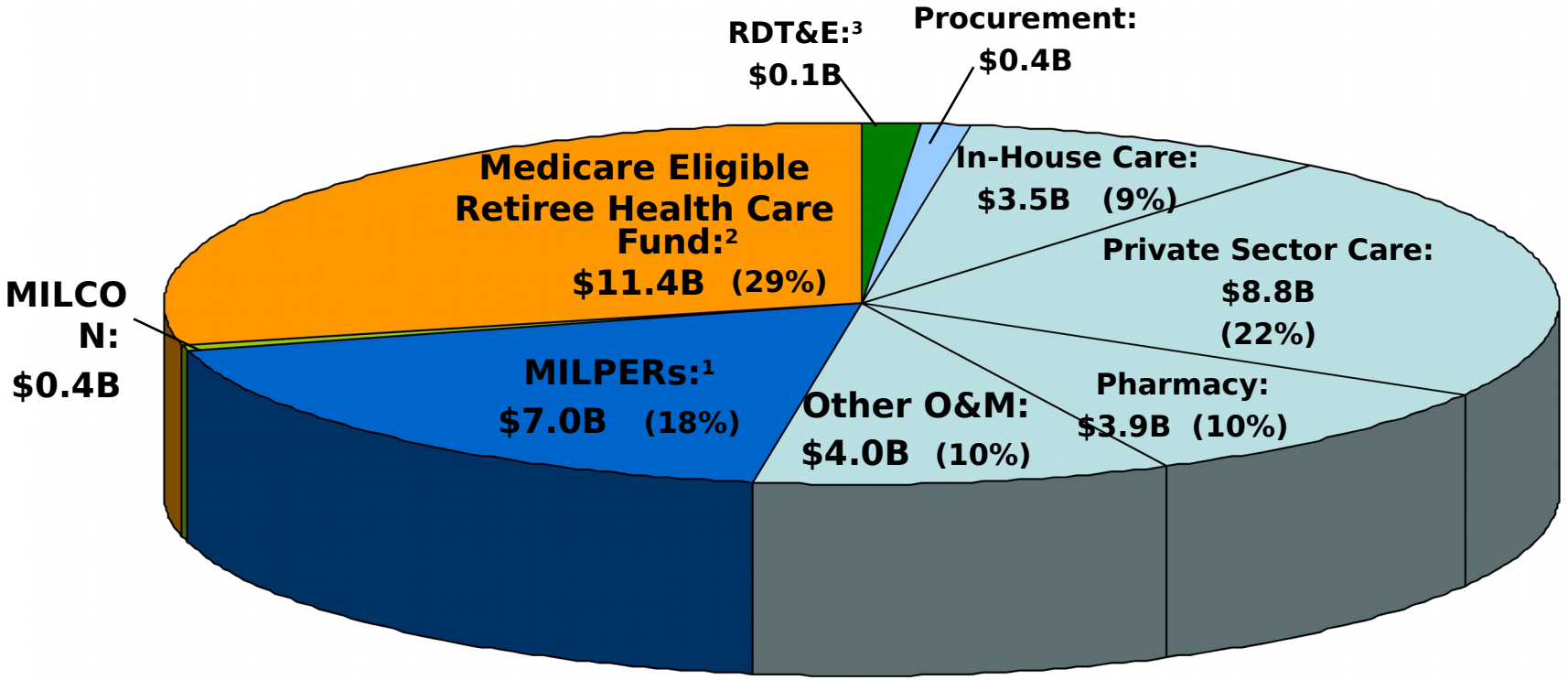
MHS: FINANCIAL UPDATE

2006 Tri-Service Health Care Facilities Symposium

Boston, MA

13 July 2006

DoD Health Care Budget FY2007



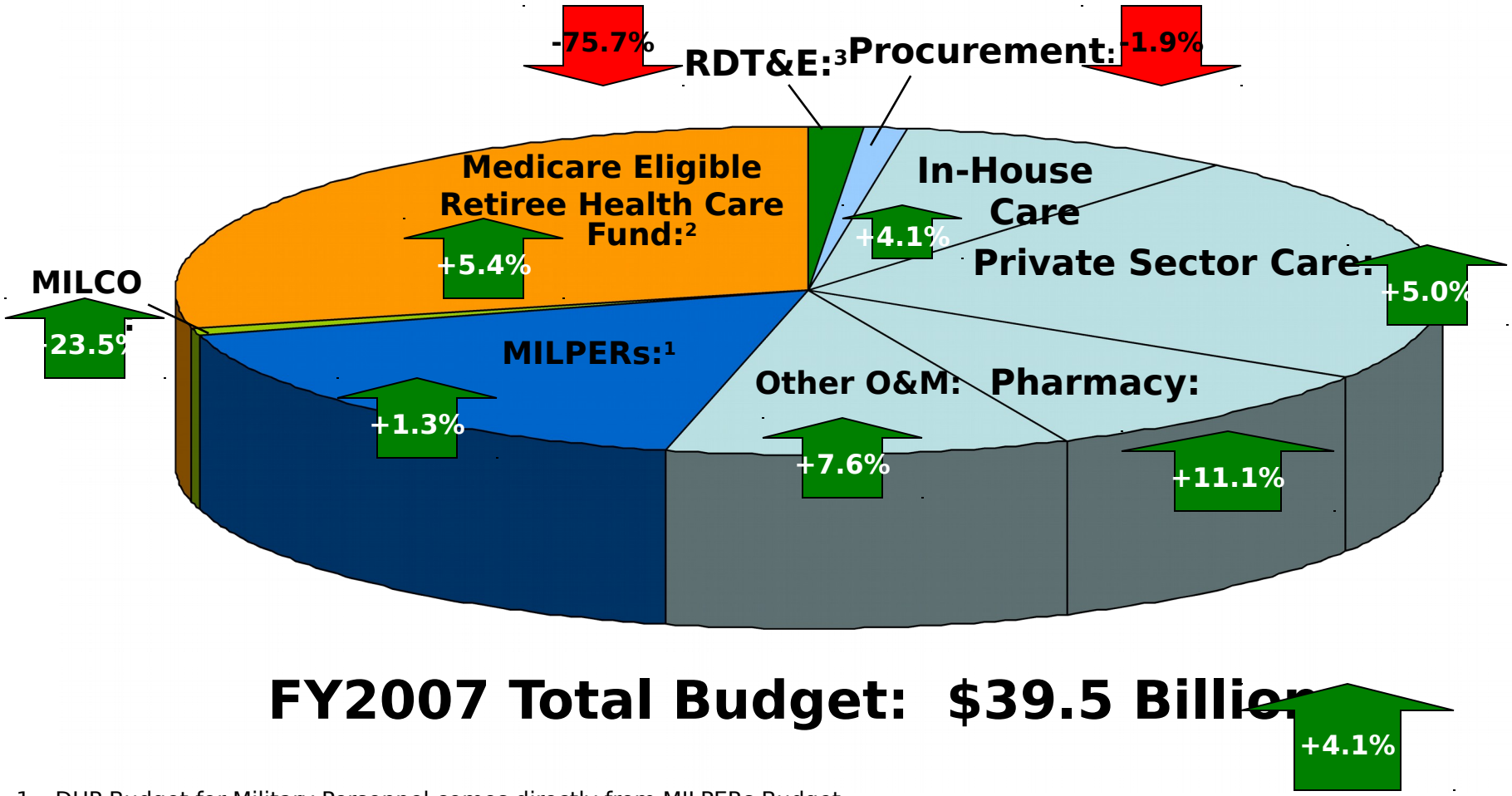
FY2007 Total Budget: $39.5 Billion

1 – DHP Budget for Military Personnel comes directly from MILPERs Budget

2 – Normal Cost Contribution paid into the Medicare Eligible Retiree Health Care Fund

3 – Excludes Congressional additions which historically have been up to $0.5 billion

Where Are We Growing Vs FY06



FY2007 Total Budget: $39.5 Billion +4.1%

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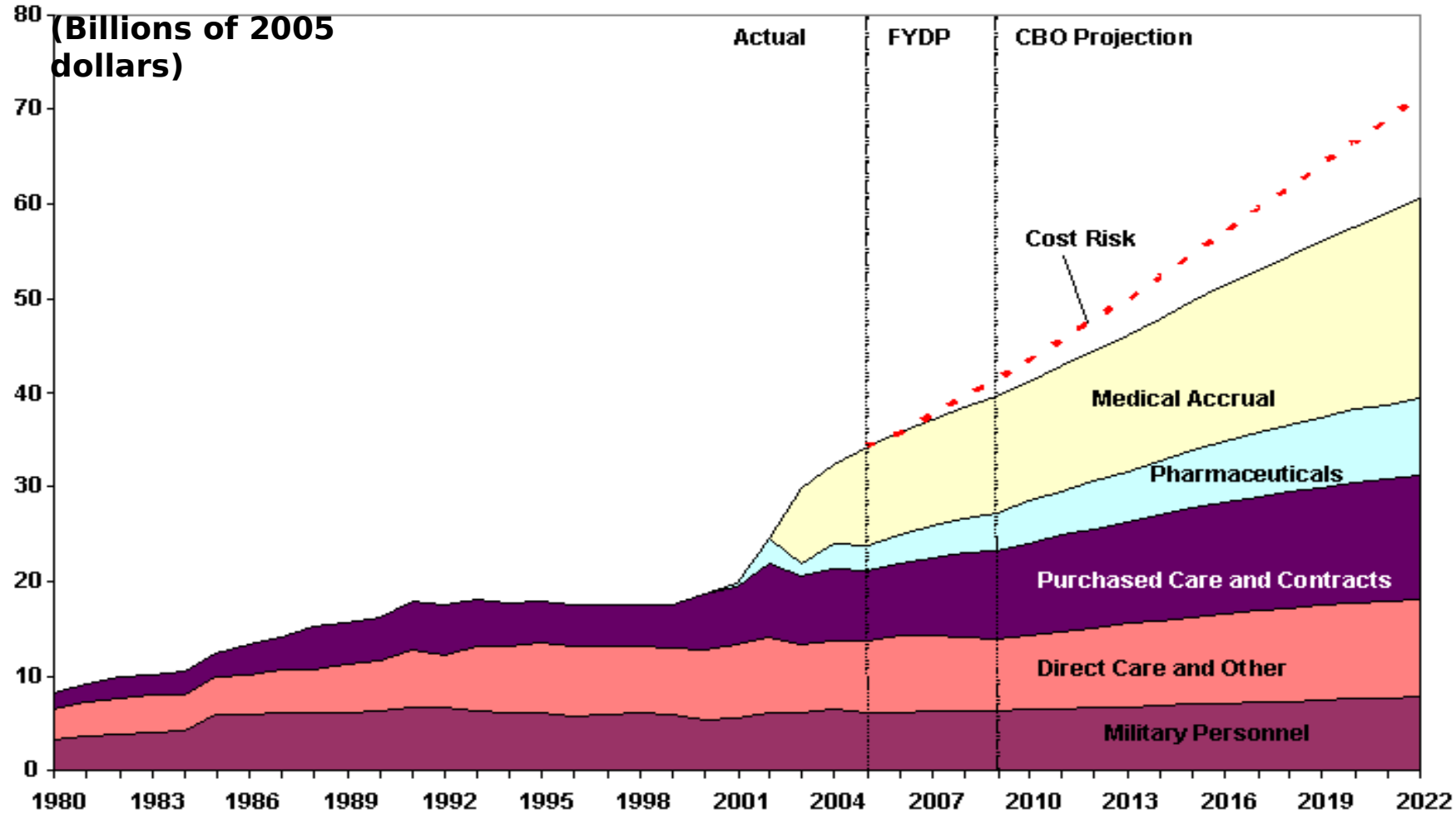
Scope Of The Problem

TRICARE today is one of the very best health plans in the world.

However:

- the Defense Health Budget has more than doubled from $18B to $37B in five years, and now represents 7.5% of total DoD spending.
- It is projected to reach $64B and more than 12% of the DoD budget by 2015.
- Such growth, left unchecked, will put tremendous strain on the DoD Budget, crowding out transformational changes, investments in needed weapons systems and sustainment capabilities to fight the war on terrorism.
- In fact, rapid growth in health spending is already creating significant stress among the Military Services.

Past and Projected Resources For MHS



Source: Congressional Budget Office

What's Causing This Growth

DoD Health cost growth is attributable to four main factors:

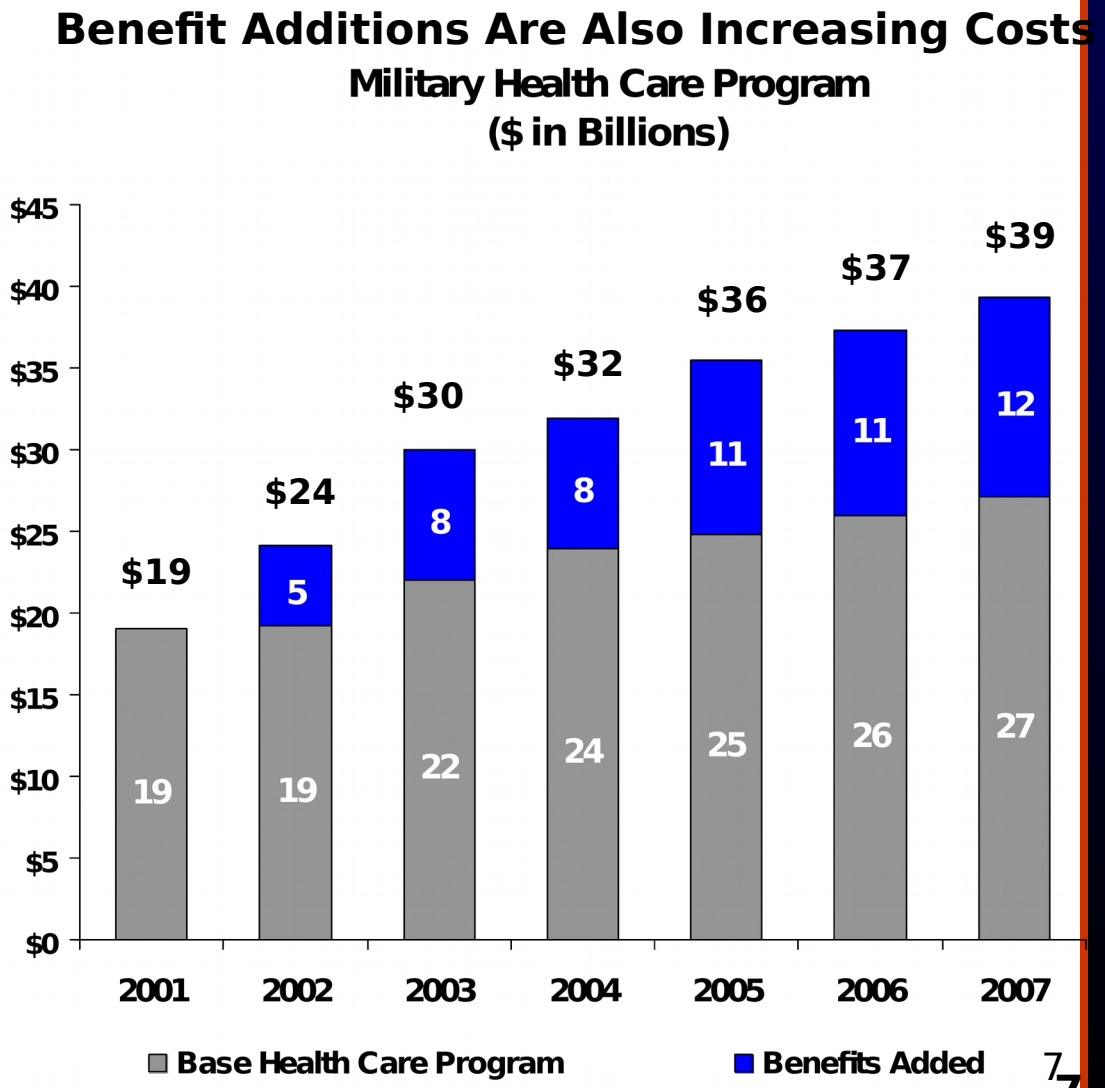
1) Expansion of TRICARE to cover more services and more beneficiary groups.
2) Beneficiary cost shares have remained unchanged for years, or decreased, or in some instances been eliminated.
3) Medical inflation rates higher than general inflation. These changes have been most pronounced since 2000.
4) Higher participation by eligible beneficiaries – Retirees <65

TRICARE was expanded in 2001 to cover all costs not paid by Medicare, including prescription drugs, for those 65 and older. In addition, co-payments were eliminated for active duty, additional

Factor #1:

Legislation Increasing Benefits

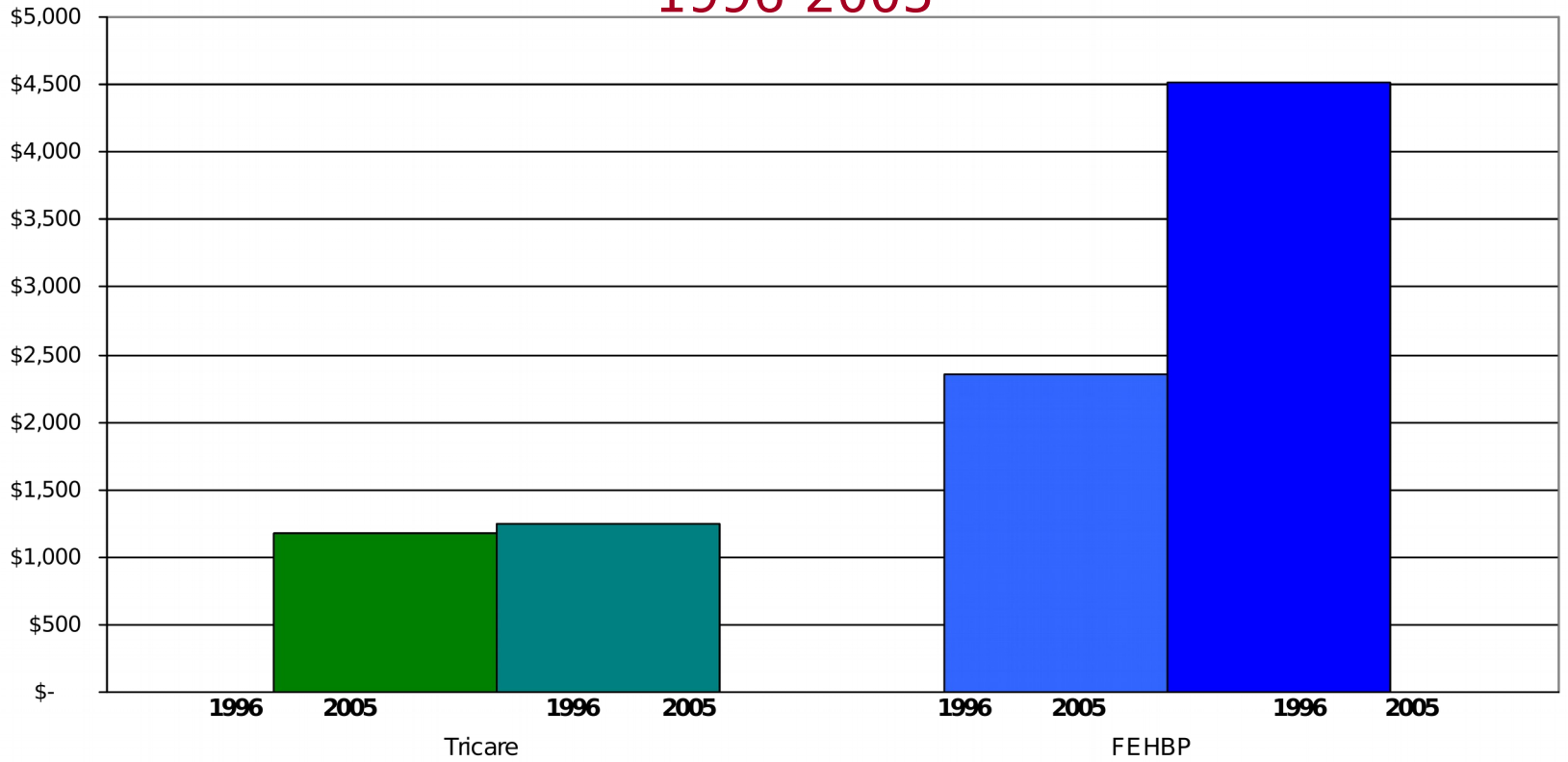
- In 2001, military health care costs were expected to grow from $19B to $27B (+43%) by 2007
- In 2002, Congressionally mandated expansion of TRICARE coverage for military retirees became effective
- With these expanded benefits, health care costs will grow to $39B (+107%) by 2007
- These expanded benefits add a cost of $68B over FY07-11
- This year, Congress may expand TRICARE coverage for Reservists (Graham amendment could cost over $6.5 Bil over 6 years)



Factor #2:

Cost Shares Have Remained Flat

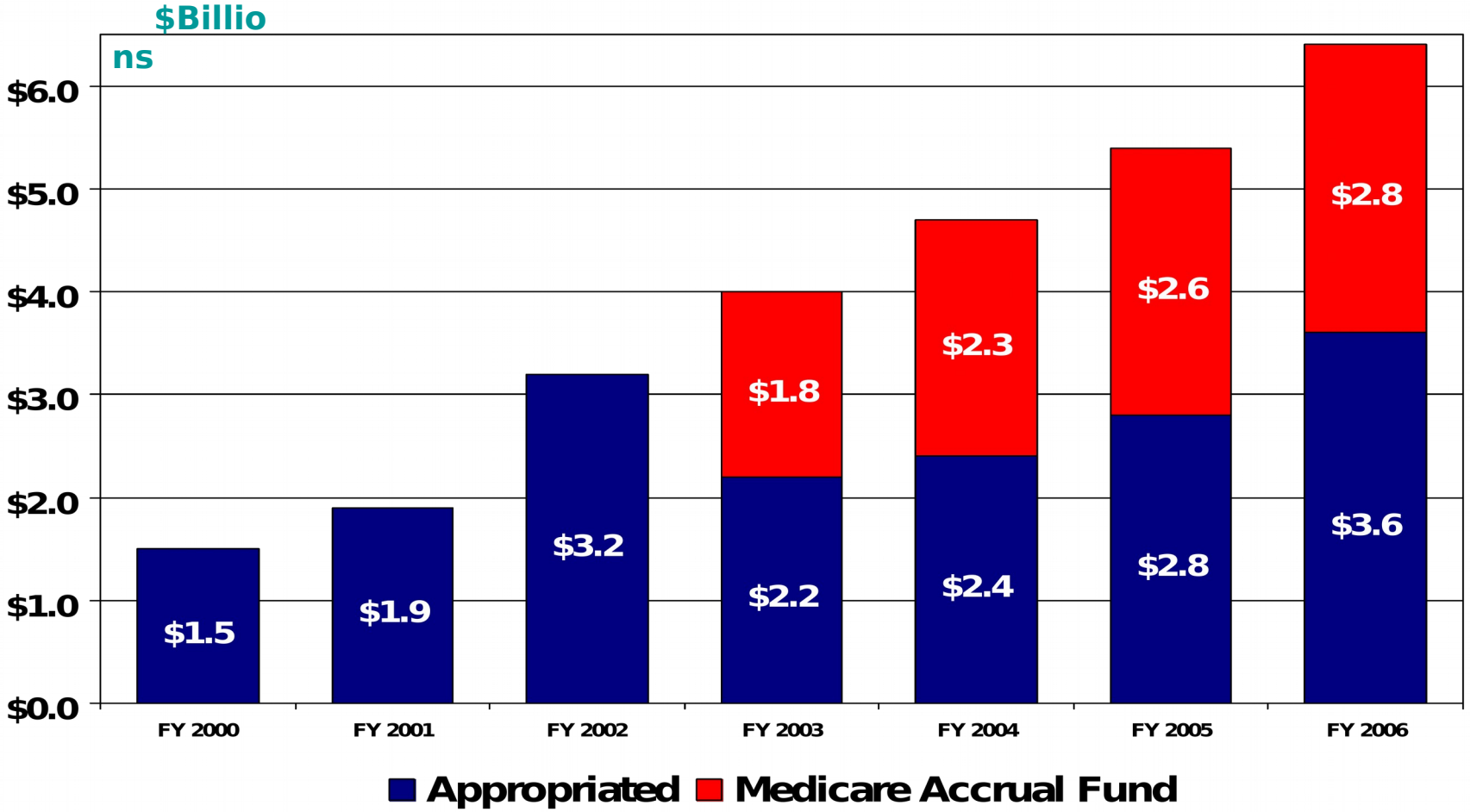
Comparison Of Cost Shares – TRICARE vs FEHBP 1996-2005



- Includes premiums and co-payments.
- Assumes all care received in the civilian sector for a family of 3.
- FEHBP estimates from Checkbook Guide.

Factor #3: High Cost Growth

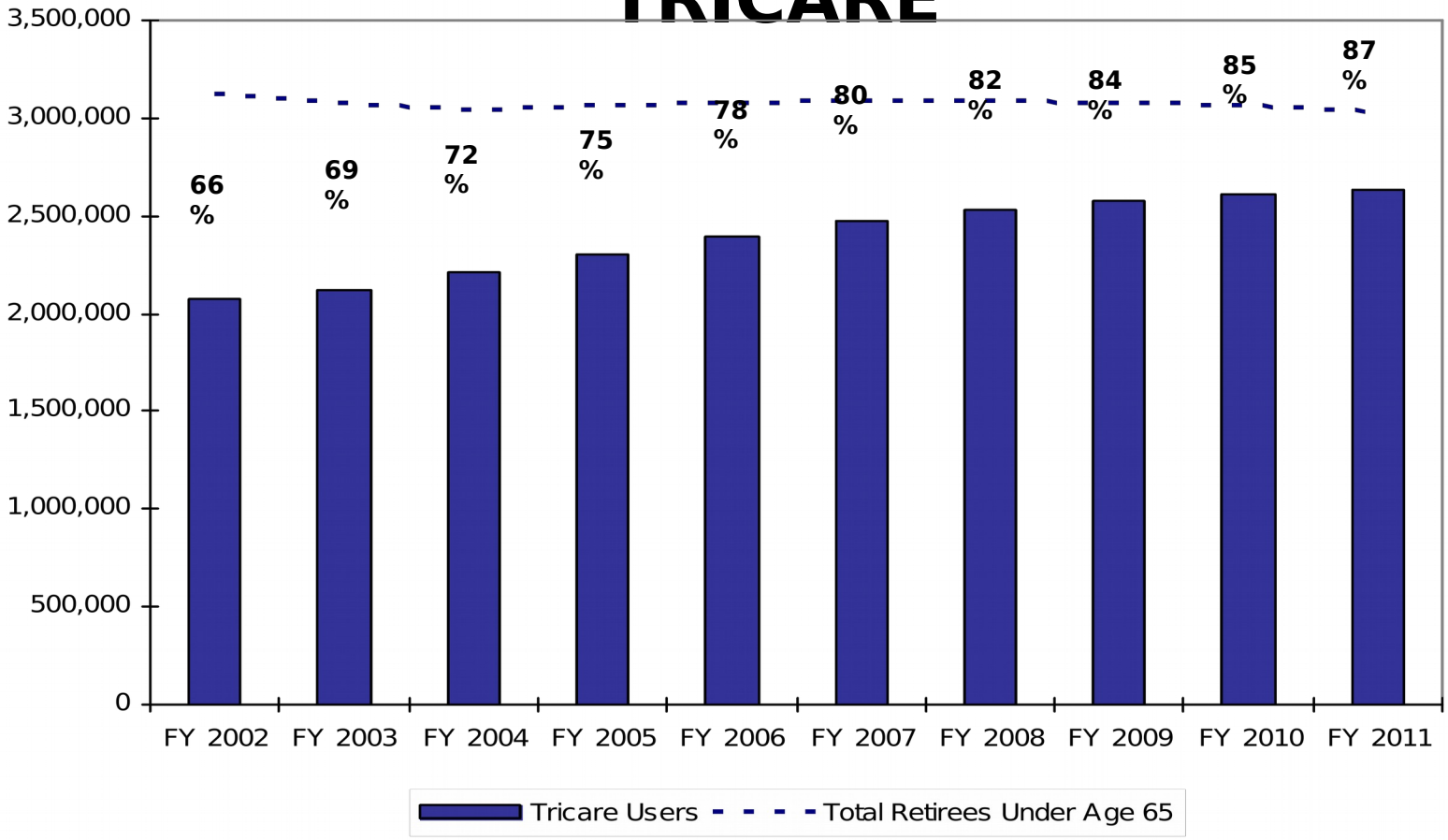
Pharmacy Expenditures Growing At A Rapid Rate



Factor #4:

Increase In Users – NADD < 65

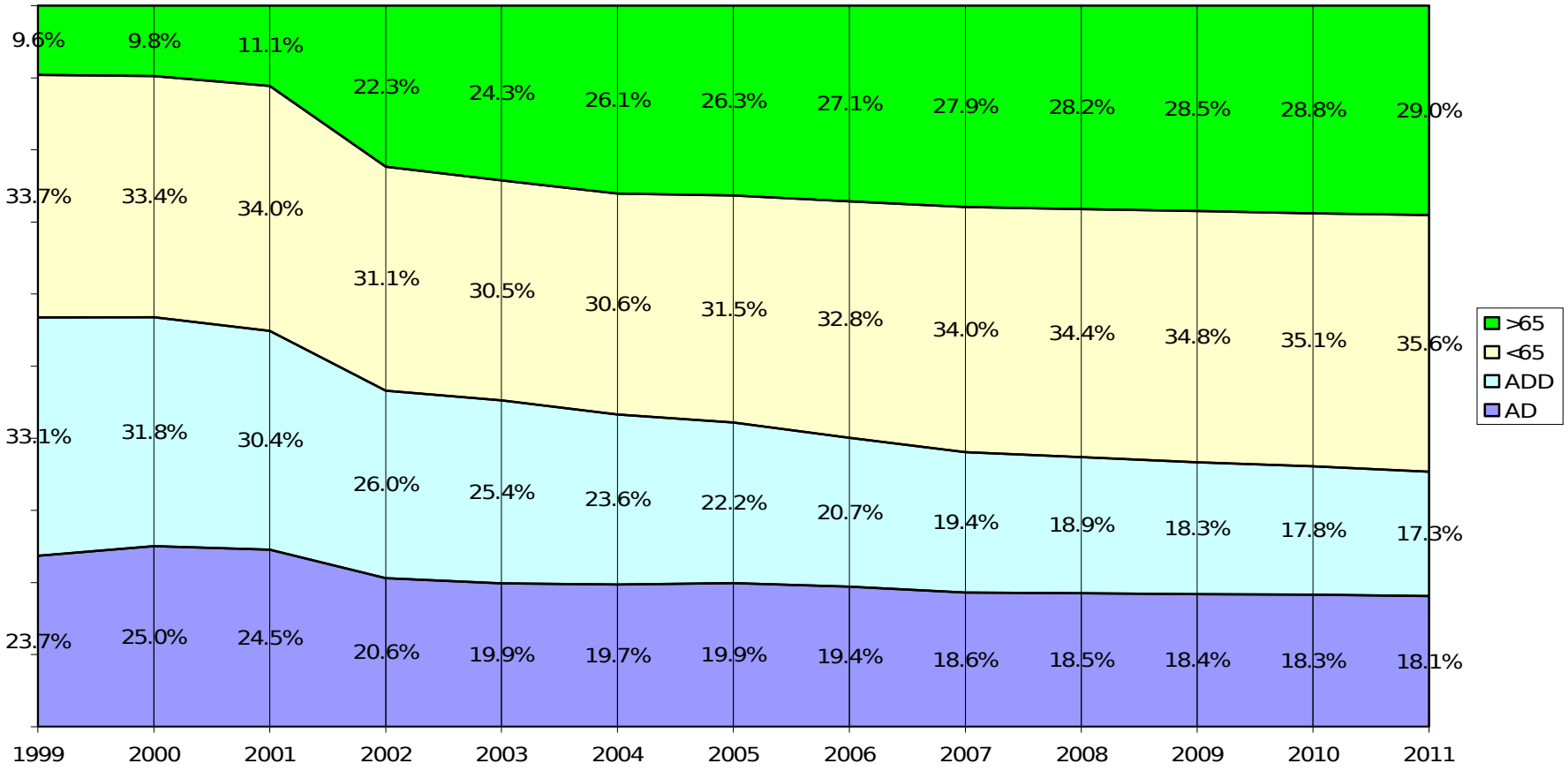
Eligible Retirees are increasingly using TRICARE



Factor #4: Increase In Users – NADD < 65

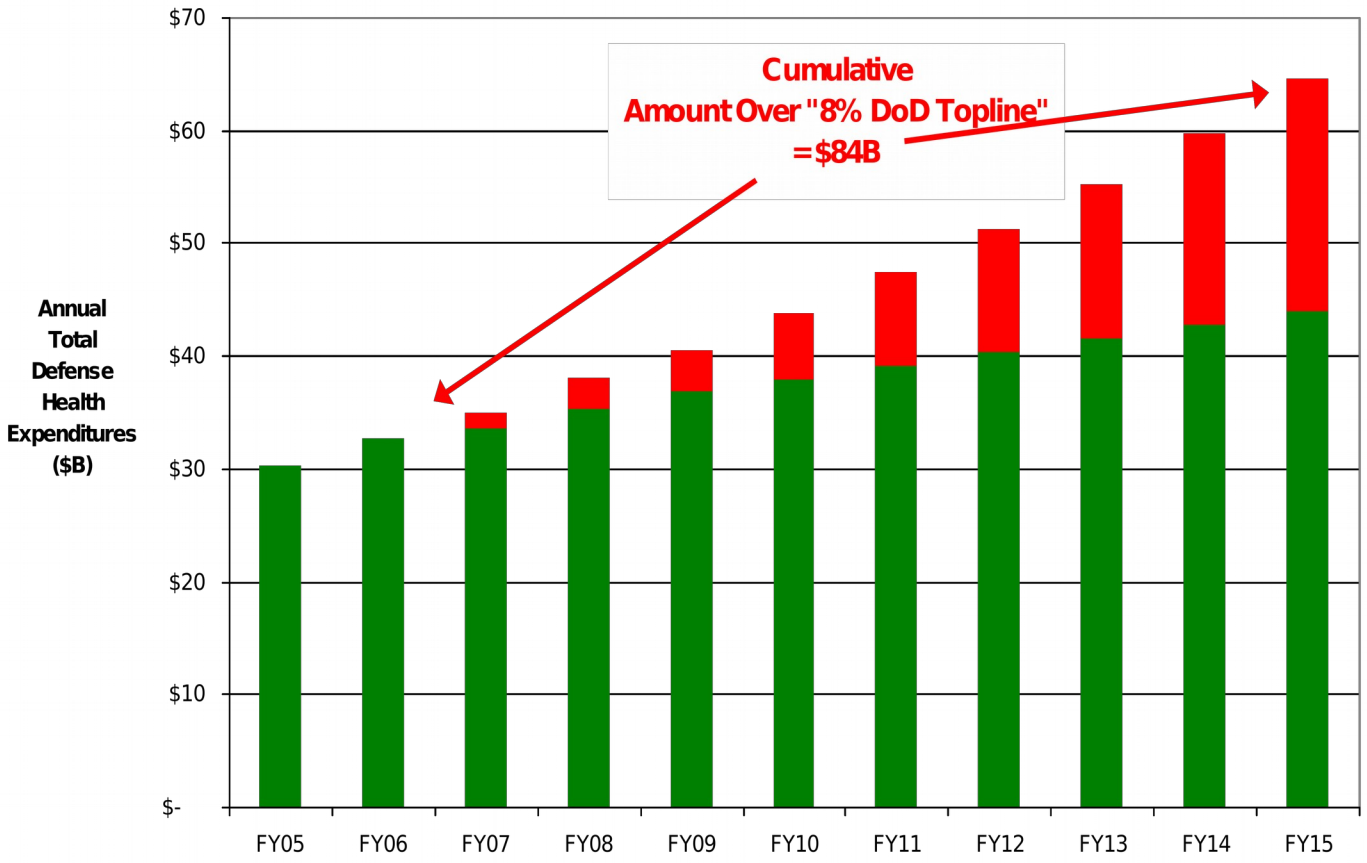
% $ Expenditure – Beneficiary Share

Percent of Health Care Expenditures* by Beneficiary Group
With <65 Retired Users Reaching 87% by 2011 and Growth Limited to MCSC



Source: TRICARE Management Activity/Office of the Chief Financial Officer: Business and Economic Analysis Division

Unchecked: MHS Budget Growth Will…

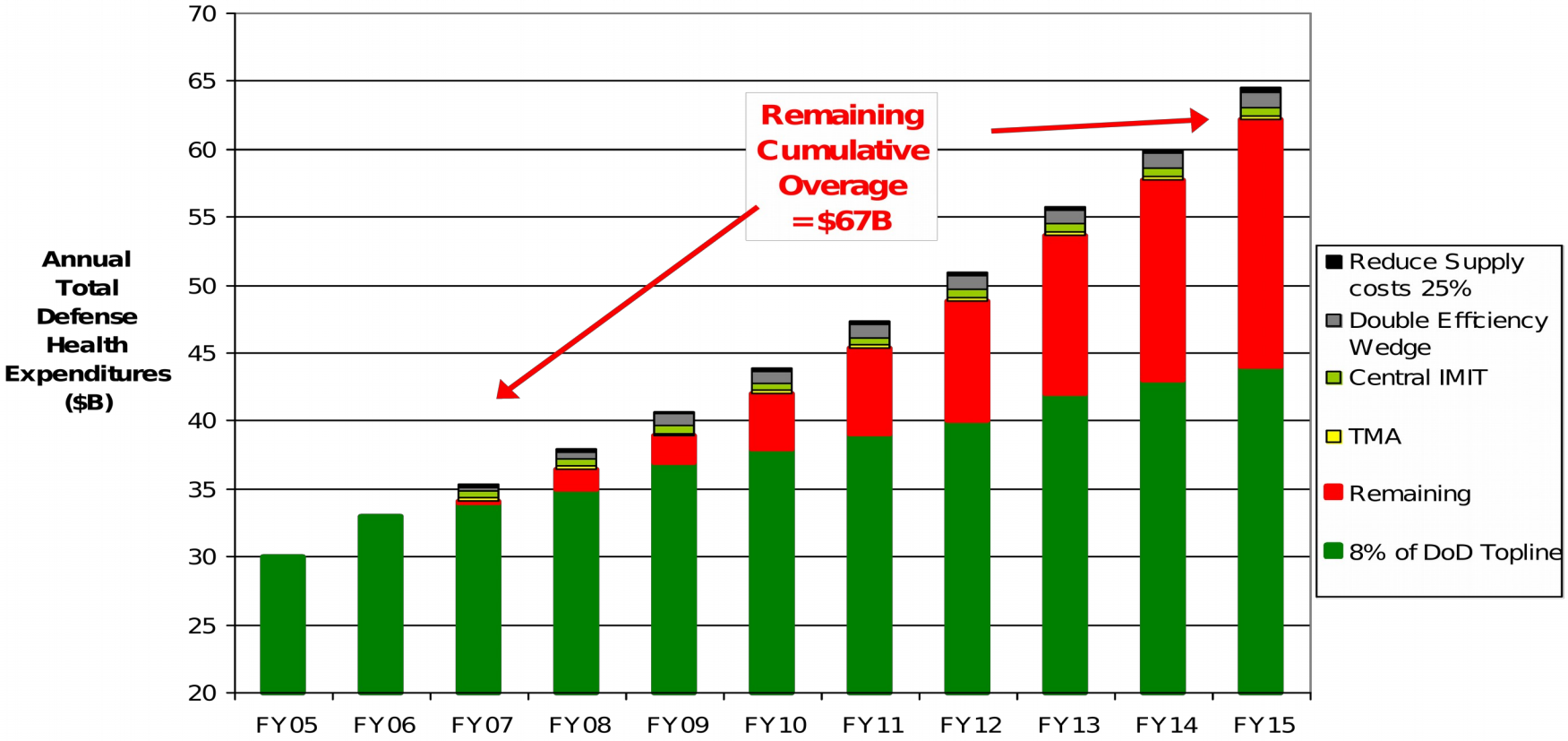


If DoD Health Budget grows at recent trend rates, it will reach $64B, or 12% of DoD topline in 2015

If DoD Health Budget constrained at 8% of DoD topline

2005 DoD Health Budget 7% of DoD topline; projections call for 12% of topline by FY15

Outpace Our Ability To Trim Costs



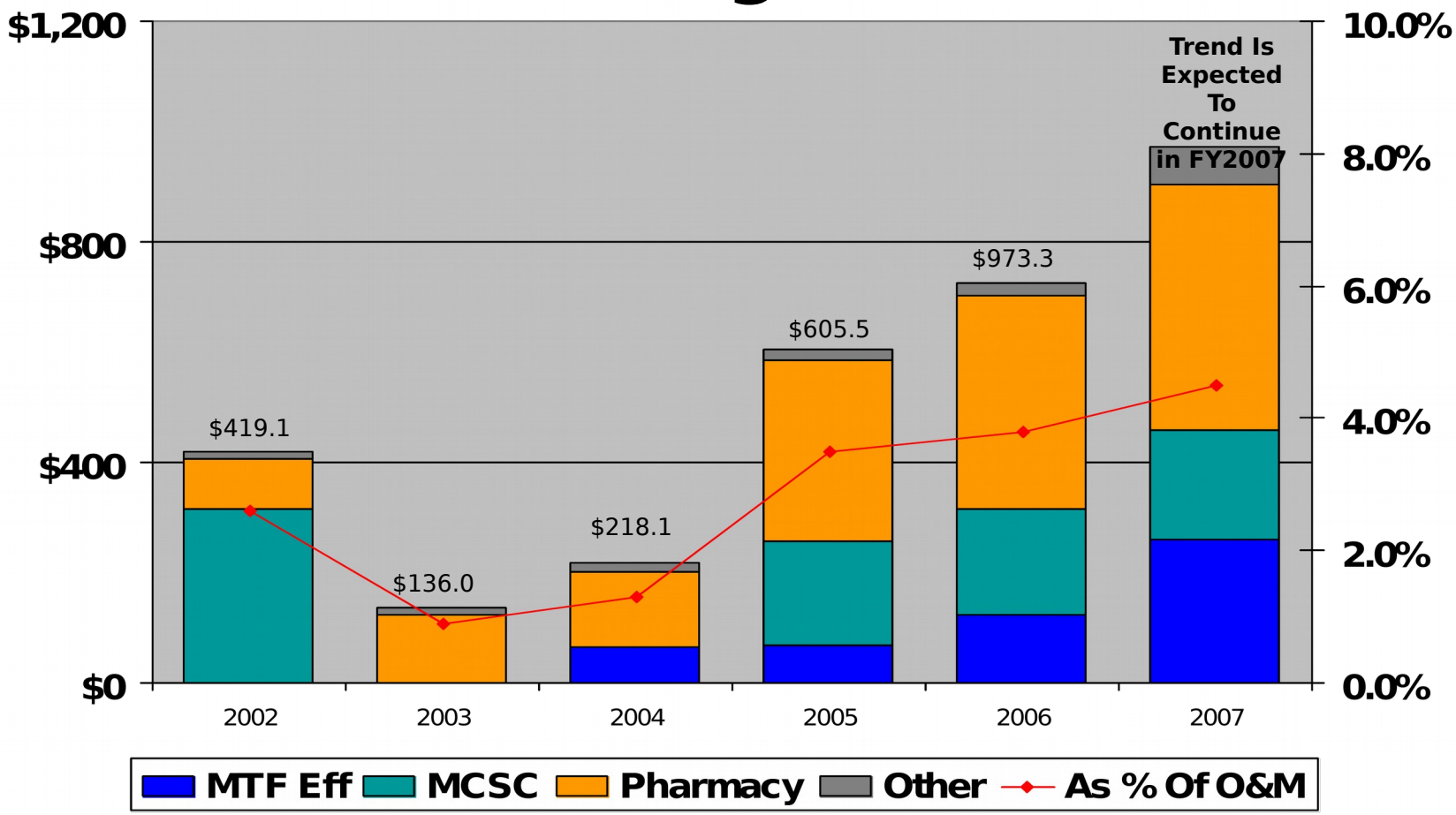
Eliminate all of TMA – Eliminate all of Central IMIT – Double the Efficiency Wedge
Reduce Supply costs in MTFs by 25%
Total reduction in FY2015 - $2.3B out of $64.5B Program

DoD Savings Initiatives

Efforts To Offset These Increases

Savings Initiatives

Annual Savings Initiatives



Savings

Pharmacy Savings Initiatives

- Electronic transfer of prescriptions from MTF to TMOP:
  - »Adds Options For Patients
  - »Eases capacity/workload at MTFs
- Promote TMOP over Retail
- Use Incentives to Encourage Generics over Brand

Savings

DoD/VA Savings Initiatives

- Joint Procurement
- Consolidated Health Informatics
- Increase in Non-GME training & education shared ventures
- Joint Facility Demo Projects: i.e. North Chicago
- Joint Incentive Fund Projects

Savings

Strategic Planning

- The main purpose of this effort: what is the key focus of organization and what will we deem as PRIORITIES.
  - » Efficiencies
  - » IM/IT Investments
- An outcome of this effort also is what we **won't** deem as a priority; what we **won't** spend our money, and what **we will not** allocate our limited resources to.

Savings

QDR#8: Transform the Infrastructure

Opportunity to reshape our medical infrastructure business process and become more cost effective. We need to find innovative ways to reduce cost and improve the quality and timeliness of recapitalizing medical facility infrastructure:

- Developing a systematic and strategic approach to provide comprehensive visibility of its assets

- Establishing a process to directly link facility investments with performance goals articulated in strategic and business planning and enhance joint operations and interagency collaboration.

- Transforming the medical military construction (MILCON)

Savings - BRAC Actions

Close Inpatient

- Fort Knox
- Keesler AFB
- MacDill AFB
- NH Great Lakes
- Scott AFB
- NH Cherry Point
- Fort Eustis
- NH Cherry Point
- USAFA

Major Realignment

San Antonio

- Lackland AFB
- Ft Sam Houston

NCR

- Andrews AFB
- Fort Belvoir
- Walter Reed AMC
- Bethesda NMC

- McChord AFB

Education Consolidation

- Specialty Enlisted Training Fort Sam Houston
- Aerospace Medicine Wright-Patterson

Centers of Excellence

- Battlefield Health and Trauma Fort Sam Houston
- Hyperbaric & Undersea Med Walter Reed- Forest Glen
- Infectious Disease Walter Reed- Forest Glen
- Aerospace Medicine Wright-Patterson AFB

Joint Operations

- Medical Biological Defense Fort Detrick
- Biomedical RDA Mgmt Ctr Fort Detrick

QUESTIONS ?